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## **QUESTIONS AND ANSWERS ABOUT THE MICHIGAN BUSINESS TAX**

### ***OVERVIEW***

#### ***1. What is the Michigan Business Tax (MBT)?***

The MBT is a five bill package that contains a replacement for the Single Business Tax and provides personal property tax relief for industrial and commercial personal property. It is contained in HB 4367 and HB 4369- HB 4372.

#### ***2. What are the objectives of the MBT?***

The objectives are to:

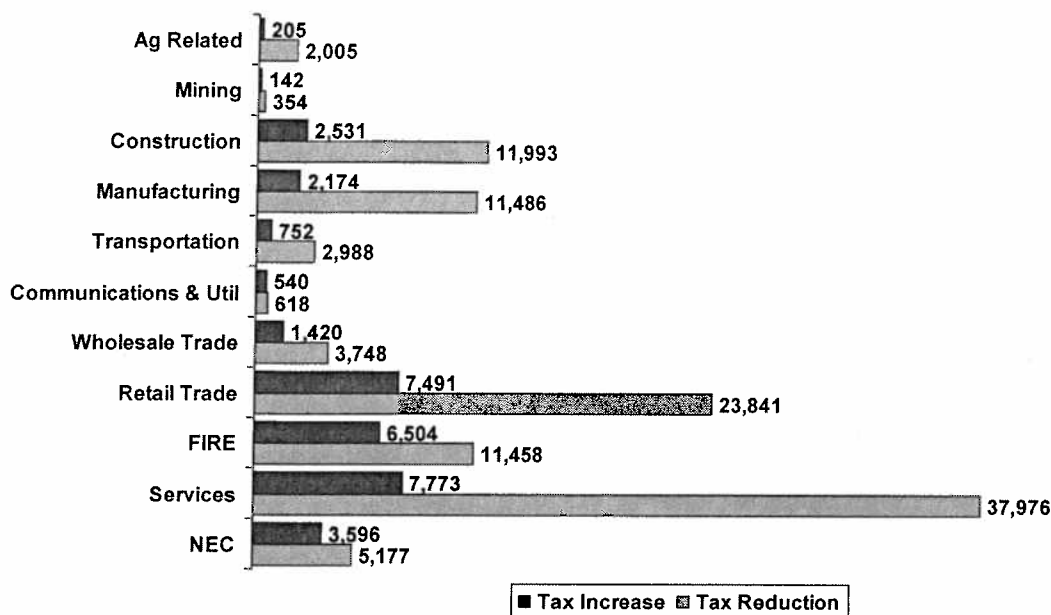
- Create a tax with the broadest base and lowest rate possible
- Provide substantial personal property tax relief
- Eliminate the addition of payroll, benefits and health care to the tax base
- Preserve economic development tools
- Spread the tax fairly to all types of businesses while maximizing the number of businesses receiving a reduction.

#### ***3. Is the tax revenue neutral?***

The MBT proposal itself is approximately a \$ 470 million tax cut. There is a \$578 million tax cut to Michigan based business and a \$250 million tax cut to small business. However, the tax cuts are paid for by a portion of the 2% tax on services.

#### ***4. What is the ratio of “winners” to “losers”?***

Approximately 112, 000 taxpayers receive a reduction under the proposal and 34, 000 see an increase. A distribution by business sector follows below.



**5. What would happen to the “winners” and “losers” ratio if the 5 bills, taken by themselves, were revenue neutral?**

The numbers of taxpayers with an increase would rise slightly but the overall ratio can still be retained at close to 3 to 1. Structure of the tax, rather than whether there is an overall tax cut, determines the liability of individual taxpayers.

**THE BASIC TAX**

**6. What is the tax base?**

The tax base consists of gross receipts, business income and assets.

**7. What is the tax rate(s)?**

The rate imposed on gross receipts and assets is 0.125%. The rate on business income is 1.875%.

**8. What is the gross receipts part of the base?**

Gross receipts are the total receipts for goods sold or services rendered during the tax year.

**9. Are there any exclusions from gross receipts?**

Yes. Two important exclusions reduce the gross receipts tax base. First, sales among affiliates that are part of a group filing a consolidated return are not included in the base. Second, in the case of the sale of an intangible asset, only the gain, if any, is included in the tax base.

***10. What is the business income portion of the tax base?***

Business income is the profit for the tax year reduced by any net operating loss from the prior year.

***11. Are there any exclusions from business income?***

Yes. Foreign dividends are not included in the MBT definition of business income. Also income from partnerships whose partners are corporations are excluded to avoid double taxation of that income.

***12. What is the assets portion of the tax base?***

Assets consist of the property, both real and tangible personal as well as intangible, that belongs to the business. They include items such as securities, loans, land, and equipment. The value is calculated using generally accepted accounting principles.

***13. Are there any exclusions from assets?***

Yes. Good will, treasury obligations, tax exempt securities, and inventory are excluded from the calculation of assets.

***14. Do all taxpayers calculate the assets part of the tax base the same way?***

No. The assets portion of the tax base for financial organizations, which include banks, mortgage companies, finance companies and financial subsidiaries, is the historic cost of real and tangible personal property. Intangible assets are excluded from the assets base of these taxpayers.

***15. What is inventory?***

Inventory includes items held for sale in a retail or wholesale operation. It also includes items that the taxpayer may customarily account for as inventory, such as a speculative building.

***16. Isn't including assets in the base like an additional property tax?***

While there is a slight tax on the property the rate is extremely low particularly when compared to the personal property tax reductions. For example, the property tax relief on an item of personal property is at least 368 times the tax attributable to that same asset and in the case of a multistate company the property tax relief can be thousands of times greater.

***17. Is including assets in the base unique?***

No. Eighteen states have some form of franchise, net worth or capital stock tax whose starting point is assets.

***18. What is apportionment?***

Apportionment is the method by which a multistate taxpayer computes the Michigan share of its national tax base. All states have some kind of apportionment formula for calculating the amount of the national tax base that is taxable in their state.

***19. What is the MBT apportionment formula?***

The formula is based 100 % on sales.

***PERSONAL PROPERTY TAX RELIEF***

***20. What personal property tax relief is provided?***

Property classified as industrial and commercial personal property is exempt from the 6-mill state education tax and the 18- mill local school district nonhomestead operating millage. On average this is a 46 % reduction in taxes on this property.

***21. How does the property tax relief affect the school aid fund?***

The exemptions reduce school aid fund revenues from the State Education Tax and require increased school aid fund expenditures from the school aid fund to fund the foundation allowance.

***22. Is the school aid fund held harmless from the revenue reductions and increased expenditure requirements?***

Yes. A portion of the service tax sufficient to cover these items is earmarked to the school aid fund.

***23. What is the effect of the personal property tax relief on local government?***

Local assessors and treasurers would be required to administer the exemption. Local government revenues would not be affected.

***SMALL BUSINESS***

***24. Is there a gross receipts threshold?***

Yes. Businesses with under \$350,000 apportioned in gross receipts are not required to file

***25. Is there a minimum tax for those who are not otherwise required to file?***

No.

***26. Can small businesses pay an alternative tax?***

Yes. Business with under \$10 million in gross receipts and income to a single owner not exceeding \$115,000 can pay a tax equal to 1.8 % of adjusted business income. Businesses in this group are all receiving a tax cut under the proposal.

***27. What is the cliff effect?***

The cliff refers to a situation under the SBT where a business with gross receipts of \$1 or more in excess of \$350,000 pays the full SBT, or, if it qualifies, the alternative tax.

***28. Does the MBT address the cliff?***

Yes. Tax is phased in for a business with gross receipts between \$350,000 and \$700,000 and effectively the rates are reduced proportionately based on the amount of their gross receipts between these two amounts. For example, assume a business with \$525,000 in gross receipts, an amount half way between these two amounts. That business's effective tax rate would be 50% of the statutory rates.

***INSURERS***

***29. What is the tax for insurers?***

Domestic companies would pay a premiums tax of 1.25 %. Each foreign company would pay the greater of the premiums tax or the retaliatory tax, which is a tax based on what a Michigan company would pay if it were doing business in that company's home state.

***30. Are the current credits for residual market assessments included?***

These credits are no longer provided.

***31. How does this change affect our tax ranking for insurers?***

Currently Michigan is 3rd lowest. After the change Michigan will be 6<sup>th</sup> lowest.

***32. Isn't the portion of the tax burden for insurers greater than their share of the economy?***

Yes, but almost all states tax insurers greater than other businesses. Michigan insurance taxes are 6<sup>th</sup> lowest as a percent of total state and local business taxes and after the change will rise to only 9<sup>th</sup> lowest.

***ECONOMIC DEVELOPMENT CREDITS***

***33. What is the nature of "previously existing commitments?"***

Projects relating to MEGA, brownfield redevelopment, and historic preservation take place in two parts. The first part is an agreement that provides a tax credit based on conduct that is completed in a subsequent year. For instance a MEGA credit may be based on compensation for a fixed number of years up to 20 based on a set number of additional jobs. A brownfield credit may be for an investment on a brownfield site that will not be completed for several years. The initial commitment may have been made prior to the repeal of the SBT but the anticipated

completion date may not be until after December 31, 2007. Since the SBT is repealed there is no tax in place against which to claim the credit. In the case of a MEGA credit there may be a number of years left in the credit agreement. In the case of a renaissance zone, a zone may have been created which promises a business tax exemption for up to 20 years.

Current law allows persons who receive approval for a brownfield or historic preservation credit to file amended SBT returns for 2007 if they complete the project in 2008 or 2009. No protections are provided for persons who have MEGA agreements or who are in a renaissance zone.

***34. How does MBT deal with these commitments?***

MBT allows credits for which a commitment was made under the SBT to be claimed under the MBT. This treatment extends to brownfield commitments, historic preservation commitments, MEGA credits, and renaissance zone designations. The provision applies to the unused years of a renaissance zone designation or MEGA credits as well as MEGA credits whose first year is scheduled to be after 2007. Unused carry forwards of brownfield or historic tax credits may also be used against the MBT

***35. How are new credits dealt with in MBT?***

Brownfield credits, historic tax credits, MEGA credits based on compensation, and renaissance zone credits are all reauthorized in their current form under the MBT.

***36. Aren't these credits unnecessary if we have the right tax system?***

Most state have special incentives for economic development. Eliminating these credits means that we would unilaterally disarm in competition over business location decisions. In many ways these credits are superior to conventional tax credits because they are based on specific performance.

***37. Are there any new credits provided in the MBT?***

Yes. There is a headquarters credit and a research innovation credit?

***38. What is the headquarters credit?***

This credit applies to a multistate business that has in Michigan its national headquarters consisting of more than 500 headquarters employees. The credit is equal to 10 % of the difference between the wage of each headquarters employee with wages in excess of the average wage on non headquarters employees and \$200,000. The credit is not refundable and may not be carried forward. The credit is estimated to provide \$240 million in tax relief annually.

***39. What is the research innovation credit?***

This is a MEGA credit that allows up to \$500,000 to match the investment of an established company in a newly formed research company. The credit is capped at \$12.5 million so that the total amount of leveraged investment will be \$25 million.